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Supreme Court of the United States

64

SUBJECT INDEX

	Page
Opinions Below	2
Jurisdiction	2
Questions Presented	2-3
Statute Involved	3
Statement	3-6
Reasons for Granting the Writ	7-10
Conclusion	10
Appendix A. Statutes	11-16
B Opinions Below	17-32
C. Conflicting Opinion	32-37

CITATIONS

Cases:

Albright v. Commissioner, 173 F. (2d) 339, C. A. 8th 8, 15, 29
Fox v. Commissioner, 198 F. 2d 719 ..... 5, 7
McDonald v. Commissioner, 214 F. 2d 341 ..... 6, 7
Miller v. U. S., 98 Fed. Supp. 948 (Neb.) 8, 15, 29
U. S. v. Bennett, 186 F. (2d) 407, C. A. 5th 8, 15, 29

Statutes:

Internal Revenue Code of 1939
Sec. 22 (26 U. S. C. 1946 ed., Sec. 22) 11
Sec. 117 (26 U. S. C. 1946 ed., Sec. 117) 5, 8, 11
Revenue Act of 1951, c. 521, 65 Stat. 452
Sec. 324 ..... 3, 8, 13

Miscellaneous:

S. Rep. No. 781, 82nd Cong., 1st Sess., pp. 41-42 9, 14

IN THE

Supreme Court of the United States

OCTOBER TERM 1954

No.....

ROBERT B. GOTFREDSON and
CHARLOTTE B. GOTFREDSON,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above entitled case on December 27, 1954, affirming the judgments of the Tax Court of the United States.

OPINIONS BELOW

The opinion of the Tax Court (R. 17) is a memorandum opinion entered August 31, 1953 and is not officially reported. The opinion of the United States Circuit Court of Appeals for the Sixth Circuit (R. 26) is reported in 217 F. 2d 673.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 27, 1954 (R. 26). A petition for rehearing was filed January 17, 1955 and an Order denying the same was entered on February 25, 1955 (R. 32). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254 (1) and Section 1141 (a) of the Internal Revenue Code of 1939 (now Section 7482 (a) of the Internal Revenue Code of 1954).

QUESTIONS PRESENTED

The following questions are presented for review:

1. Whether the gain realized by the petitioner, Robert B. Gotfredson, during the years 1948 and 1949 from the sale of raised cattle from his dairy herd and held by him for six months or more constituted ordinary income or capital gain under the provisions of Section 117(j) (1) of the Internal Revenue Code of 1939, as amended by Section 324 of the Revenue Act of 1951.

2. Whether the ultimate finding and conclusion of the Tax Court, which the Circuit Court held was binding upon it, namely, that under the petitioner's standard of selective breeding, cows and heifers which were less than thirty-six (36) months of age and bulls which were less than forty-eight (48) months of age at the time of sale were not held by petitioner for dairy purposes but for sale to customers, was based upon an erroneous application and construction of Section 117(j) (1) of the Internal Revenue Code of 1939, as amended by Section 324 of the Revenue Act of 1951 (now Section 1231 (b) of the Internal Revenue Code of 1954).

STATUTE INVOLVED

The pertinent statutory provisions are printed in Appendix A, *infra,* pp. 11 to 14.

STATEMENT

The principal facts as found by the Tax Court are not in dispute (R. 26). The petitioner, Robert B. Gotfredson, since about 1940 has owned and operated a farm located at Jackson County, Michigan, consisting of about fifteen hundred acres. The principal source of income from the operation of the farm has been from the sale of dairy products. The petitioner early adopted the policy of building up a herd of top-grade milk producing cattle of the Brown Swiss breed to the point of maximum operational efficiency on the acreage available. The Brown Swiss breed is considered primarily a milk producer and not a beef producer. Petitioner, in selecting cattle which are to be retained for milk production purposes, maintains a

standard and follows the practice of selective breeding. In maintaining and improving the efficiency of his dairy herd, the petitioner culls out the less desirable animals, replaces the older animals whose production has dropped with younger animals raised on the farm, and from time to time acquires new sires from other herds. Of the animals born on the farm each year the petitioner intends to retain as many as he thinks he can use. However, his aim is to retain the better ones for milk production purposes and to cull out the poorer ones in order to improve the quality of his herd. At various stages of development the cattle are judged by predetermined standards, and the poorer animals which fail to measure up to such standards are sold (R. 18, 26).

The following is a statement of petitioner's gross income from the sale of dairy products produced on the farm, from the sale of cattle raised on the farm, and the net loss resulting from farm operations, exclusive of the receipts from the sale of cattle during the years in question (R. 20).

Year	Gross income from sale of dairy products	Gross income from sale of cattle	Net loss on farm operations exclusive of receipts from sale of cattle
1948	$48,466.42	$16,705.56	$21,050.10
1949	37,772.03	16,234.31	43,912.55

During the year 1948, the petitioner spent the sum of $337.00 and during the year 1949 the sum of $273.90 in advertising his cattle (R. 21).

Practically all of the cows and heifers involved herein had been bred at the time of their sale, some had dropped a calf and had been used for milking. Most of the bulls had reached breeding age and some had been bred at the time of their sale (R. 20).

The petitioners in their income tax returns for the calendar years 1948 and 1949 reported the proceeds received from the sale of cattle from said dairy herd which had been raised by the Petitioner Robert B. Gotfredson and held by him for more than six months as capital gains (R. 21). The respondent determined that all of such income was taxable as ordinary income and not as capital gain and assessed deficiencies against the petitioners accordingly.

The petitioners filed their petition in the Tax Court contesting the proposed deficiencies on the ground that the gain realized from the sale of said dairy cattle constituted capital gain within the provisions of Section 117(j) (1) of the Internal Revenue Code of 1939 (26 U. S. C. 117(j) (1)) as amended by Section 324 of the Revenue Act of 1951.

The Tax Court held that under the petitioner's standards, cows under thirty-six months of age and bulls under forty-eight months of age were not held for dairy purposes, but instead were held for sale to customers, and that the gain on their sale was taxable as ordinary income; and that cows which were thirty-six months of age or more and bulls which were forty-eight months of age or more at the time of sale were held by the petitioner for dairy purposes and not primarily for sale in the ordinary course of business, and that the gain on their sale was taxable at capital gain rates. The ultimate finding and conclusion of the Tax Court was predicated upon its determination that at no time prior to the expiration of thirty-six months in the case of cows and forty-eight months in the case of bulls could it be said that such cattle were part of the petitioner's dairy herd. The position so taken by the Tax Court was founded upon the opinion of the Court of Appeals for the Fourth Circuit in *Fox v. Commissioner,* 198 F. 2d 719.

While the within case was pending for review before the United States Court of Appeals for the Sixth Circuit and after the briefs had been filed therein, the United States Court of Appeals for the Second Circuit decided the case of *McDonald v. Commissioner,* 214 F. 2d 341 (R. 32) and refused to adopt the reasoning employed and, in effect, repudiated the principles set forth by the Fourth Circuit in *Fox v. Commissioner, supra,* wherein it was determined that the cattle therein considered were not held for inclusion in the taxpayer's breeding herd. This conclusion of the *Fox* case was arrived at from a finding that the cattle sold were not part of the taxpayer's herd until they had dropped a calf in the case of females, and had reached an age at which it could be determined that they possessed the necessary qualities for such a herd in the case of bulls.

The court below affirmed the judgment of the Tax Court herein and in its decision recognized that the Court of Appeals for the Second Circuit in *McDonald v. Commissioner, supra,* had recently, reached a different result from that reached in *Fox v. Commissioner, supra,* saying that if the matter were before it in a trial *de novo,* the reasons given for the ruling in the *McDonald* case would be persuasive and that the two cases represent different conclusions of similar factual situations both reasonably arrived at. The Sixth Circuit, however, held that eliminating the legal issues involved, the basic question was one of fact and that the Tax Court having found that the cattle had not been held for dairy purposes, and being unable to say that such findings was clearly erroneous, the same was binding upon the Circuit Court.

REASONS FOR GRANTING THE WRIT

The general principles or reasoning involved in the decisions below in the within case and in *Fox v. Commissioner,* 198 F. 2d 719, upon the authority of which the instant case was decided, are in conflict with the principles and reasoning involved in the decision of the Second Circuit Court of Appeals in *McDonald v. Commissioner,* 214 F. 2nd 341 (Appendix C, *infra,* p. 32).

The ultimate finding and conclusion of the Tax Court that the cattle in question were not part of petitioner's dairy herd, which the Sixth Circuit held was binding upon it, was bottomed upon the reasoning of the Fourth Circuit in *Fox v. Commissioner, supra,* which the Second Circuit in *McDonald v. Commissioner, supra,* refused to adopt and, in effect, repudiated. In the *Fox* case it was found as an ultimate fact that the cattle raised on the farm were not to be deemed part of the petitioner's breeding herd until they had reached such an age as to test their breeding qualities, which the court determined was twenty-six (26) months in the case of females and thirty-four (34) months in the case of bulls. In the *McDonald* case, wherein the facts were similar to the within case, the Second Circuit held, contrary to the reasoning in the *Fox* case that although it could not be definitely ascertained that the cattle retained would measure up to the standards set for the herd, and that many of the animals would be found wanting and be sold, nevertheless, such cattle were part of the herd held for dairy and breeding purposes until sold, and that the gains realized from such sales constitute capital assets under Section 117(j) (1) of the Internal Revenue Code of 1939, as amended by Section 324 of the Revenue Act of 1951. The Second Circuit held that the reasoning of the Tax Court

therein adopting the reasoning of the *Fox* case penalized breeders who were endeavoring to maintain the high quality of their herd, through the process of selective breeding by culling and weeding out from the herd cattle which did not measure up to the taxpayers predetermined standards.

The Court below and the Fourth Circuit in the *Fox* case on the one hand, and the Second Circuit in the *McDonald* case on the other hand, have thus arrived at different ultimate findings on similar factual situations. There is here presented a conflict arising out of the differences between the general principles and the reasoning involved in the decisions in the Court below and the *Fox* case, and the decision in the *McDonald* case, leaving the law in an unsatisfactory state and unsettled condition, so as to require a review by this Court of the issues herein, in order that there may be brought about uniformity of decisions among the Circuit Courts.

Involved herein are questions of public importance in the administration of the Tax Laws relating to the application to be given under the 1951 Amendment to Section 117(j) (1) of the Internal Revenue Code of 1939 to the sales of cattle made by the farmers of the country who maintain dairy and breeding herds. Prior to the enactment of the 1951 Livestock Amendent (Section 324, Revenue Act of 1951), the Commissioner first took the position that the sale of livestock did not constitute a sale of capital assets under Section 117(j) (1) of the Internal Revenue Code. Following a series of Court decisions adverse to the position so taken by the Commissioner, *Albright v. Commissioner,* 173 F. (2d) 339, C. A. 8th; *U. S. v. Bennett,* 186 F. (2d) 407, C. A. 5th; and *Miller v. U. S.,* 98 Fed. Supp. 948 (Neb.), the Commissioner was led to recede from the position taken so as to allow capital gains treatment, but

only to animals sold after being employed for substantially their full period of usefulness, thus limiting the application of the decisions of the foregoing cases, which had accorded capital gains treatment to the proceeds from the sale of young animals, (hearings before Committee on Finance on H. R. 4473, Rev. Act of 1951, Part 3, pp. 1538, 1837, 2396; Se. Rep. No. 781, 82d Cong., 1st Sess. 41-42.) The report of the Committee on Finance filed with the Senate, which is set out in full in the Appendix (R. 14) reviews the earlier difficulties with the Commissioner and the decided cases and specifically states that the intention of the Amendment was to make Section 117(j) (1) applicable to livestock "whether old or young", and to have the holding period "start with the date of acquisition, not with the date the animal is put to such use". The attention of Congress was drawn not only to the aforesaid position of the Commissioner to limit the capital gains treatment to gains from the sale of older animals, but also to the decision of the Tax Court in the *Fox* case which limited capital gains treatment to gains from the sale of animals which had been bred and had actually produced calves. The Congress in enacting the Amendment intended to clarify the situation by including within the definition of "property used in the trade of business" livestock "regardless of age held by the taxpayer for draft, breeding or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry." Congress, by the amendment, intended to remove the confusion which had existed between the Commissioner and the Courts; but this confusion continues to exist because of the conflict in the principles and reasoning involved in the interpretation and construction of said Section, as amended, by the Circuit Courts. The reasoning in the Court below and in the *Fox* case, in effect,

is that cattle are not to be deemed part of a breeding or dairy herd until they have been bred and have produced calves; whereas, the principle and reasoning in the *McDonald* case is to the effect that where the taxpayer, in employing the process of selective breeding, detects and culls inferior animals, even before they have been bred, such animals are part of the regular herd before they have been thus weeded out, and are held for dairy and breeding purposes until they are proven unfit.

There is here presented a conflict of decisions involving the construction and application of the provisions of Section 117(j) (1) as amended, which should be resolved by this Court. The issue being one of continuing importance to the farmers of the country under the 1939 and 1954 Revenue Codes, widespread litigation will ensue unless the point is settled by this Court.

CONCLUSION

For the foregoing reasons, the within Petition for Writ of Certiorari should be granted.

Respectfully submitted,

NATHANIEL W. GOLD,
Counsel for Petitioners,

THOMAS F. CHAWKE,
Of Counsel.

Dated May 9, 1955.

APPENDIX A

STATUTES

Internal Revenue Code of 1939:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C., 1946 ed., Sec. 22.)

Sec. 117. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or properly held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1);

* * * * *

(4) [as amended by Sec. 150(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(b) [as amended by Sec. 150(c) of the Revenue Act of 1942, supra] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(j) [as added by Sec. 151 (b) of the Revenue Act of 1942, *supra*, and amended by Sec. 127 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U. S. C. 1946 ed., Sec. 117.)

Revenue Act of 1951, c. 521, 65 Stat. 452:

Sec. 324. Sales of Livestock.

Section 117 (j) (1) is hereby amended by adding at the end thereof the following new sentences: "Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such

term does not include poultry." The first sentence added to section 117 (j) (1) by the amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months shall be applicable only with respect to taxable years beginning after December 31, 1950. The second sentence added to section 117 (j) (1) by the amendment made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950. (26 U. S. C. 1946 ed., Supp. V, Sec. 117.)

S. Rep. No. 781, 82d Cong., 1st Sess., pp. 41-42 (1951-2 Cum. Bull. 458, 487-488):

8. *Gains from sales of livestock.*

Section 117(j) of the Code provides, in effect, that a net gain from sales of "property used in the trade or business" of a taxpayer and held for more than 6 months is to be treated as a capital gain. In the case of a loss, it is to be treated as an ordinary loss. However, section 117(j) states that this treatment is not to apply to "property of a kind which would be properly includible in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." In the case of farmers there has been considerable confusion and dispute for several years as to whether all livestock held for draft, dairy, or breeding purposes is "property used in the trade or business," or whether in some cases the livestock should be deemed held "primarily for sale to customers in the ordinary course of his trade or business."

Rulings of the Treasury Department issued in 1944 and 1945 held that the capital gains treatment was applicable only in the case of unusual sales such as those which would reduce the normal size of the herd or those resulting from a change of breed or other special circumstances, and that the capital gains treatment would not apply to the customary sale by a farmer of old or disabled animals culled

from the breeding herd and replaced by young animals produced by the breeding herd. Early in 1949 the United States Court of Appeals, Eighth Circuit, held in the *Albright* case (173 F. 2d 399) that animals used for breeding purposes, whether or not sold as culls in the ordinary course of business, constituted "property used in the trade or business" within the meaning of section 117(j). That decision specifically applied to dairy cattle and hogs but was applicable by implication to other types of livestock.

Notwithstanding the *Albright* decision, the Treasury Department continued to adhere to its position initiated in the 1944 and 1945 rulings, pending possible contrary decisions in other courts which might result in a conclusive decision by the Supreme Court. The Revenue Act of 1950 as passed by the Senate contained a provision intended to clarify this situation, but this was rejected in conference, principally because it referred to "cattle" and thus did not clear up the situation with respect to other forms of livestock such as sheep and hogs. However, the conference committee expressed the hope that the Treasury would follow the *Albright* decision.

In January 1951 the United States Court of Appeals, Fifth Circuit, decided the *Bennett* case (186 F. (2d) 407) in a manner similar to the *Albright* decision. Subsequently the Bureau of Internal Revenue issued a ruling, Mim. 6660, stating that the capital gains treatment provided by section 117(j) would be applied to sales of culls. However, this ruling contained a statement that this treatment might not be applied in the case of animals "not used for substantially their full period of usefulness." This exception appears to have resulted in new uncertainties, and it has been stated that Bureau agents are interpreting this ruling to mean that only animals which have completely outlived their usefulness can qualify for the capital gains treatment.

The House bill added a new sentence to section 117(j) (1) providing that the term "property used in the trade or business" includes "livestock held by the taxpayer for draft, breeding, or dairy purposes for 12 months or more."

In view of the uncertainties resulting from the recent ruling (Mim. 6660), Section 324 of your committee's bill restates the sentence contained in the House bill as follows:

Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition.

Under your committee's bill, the term "livestock" does not include poultry except that it does include turkeys, regardless of age, held by the taxpayer for breeding purposes and held for 12 months or more from the date of acquisition. Thus section 117(j) will apply to livestock used for draft, breeding, or dairy purposes, and to turkeys used for breeding purposes, whether old or young; and the holding period will start with the date of acquisition, not with the date the animal or fowl is put to such use.

The provision of the House bill is effective with respect to taxable years beginning after December 31, 1950. Your committee's bill makes the amendment applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months and the amendment with respect to poultry and turkeys both apply only in the case of taxable years beginning after December 31, 1950.

Your committee believes that the gains from sales of livestock should be computed in accordance with the method of livestock accounting used by the taxpayer and presently recognized by the Bureau of Internal Revenue.

The revenue loss under this provision is expected to be $15 million in a full year of operation.

APPENDIX B

OPINIONS BELOW

Pertinent Portions of Memorandum Findings of Fact and Opinion of The Tax Court

Gotfredson v. Commissioner of Internal Revenue

"Withey, *Judge:* The respondent determined deficiencies in income tax of the petitioners as follows:

Docket No.	Year	Deficiency
37413	1948	$7,567.54
38407	1949	7,769.26

The issues presented for determination are the correctness of the respondent's action (1) in disallowing a deduction taken for 1948 for a non-business bad debt and (2) in determining that the gains realized in 1948 and 1949 from the sale of certain cattle held for six months or more constituted ordinary income.

FINDINGS OF FACT

The petitioners are husband and wife, residents of Detroit, Michigan, and filed their joint income tax returns for 1948 and 1949, prepared on the cash basis, with the collector for the district of Michigan.

* * * * *

Since about 1940 the petitioner has owned and operated what is known as the "Gotfredson Farms," which consists of about 1,500 acres situated at Grass Lake, Jackson County, Michigan. The principal source of income from the operation of the farm has been from the sale of dairy products. About 85 per cent of the feed required for the cattle is grown on the farm and the remainder is purchased. In 1948 and 1949 approximately 20 per cent of the total acre-

age of the farm was devoted to pasture. During years with rainfall normal for the growth of feed and pasture, the farm is capable of maintaining about 325 head of cattle.

In an effort to place the farm on a profitable basis, the petitioner early adopted the policy of building up a herd of top grade milk-producing cattle of the Brown Swiss breed to the point of maximum operational efficiency on the acreage available. The Brown Swiss breed is not a dual-purpose breed in that it is considered a milk producer primarily and not a beef producer.

In maintaining and improving the efficiency of his dairy herd, the petitioner culls out the less desirable animals, replaces with younger animals raised on the farm the older animals whose production has dropped, and from time to time acquires new sires from other herds.

Of the animals born on the farm each year the petitioner intends to retain as many as he thinks he can use. However, his aim is to retain the better ones and continually cull out the poor ones in order to improve the quality of his herd.

During 1948 and 1949 some of the cattle raised on the farm were sold before attaining the age of six months. Other cattle were retained beyond that age and it is some of the latter group which are involved here. In selecting cattle which are to be retained for milk production purposes, the petitioner maintains a standard. Under that standard a heifer must be of good conformation and at first calving, as a two-year old, produce at least approximately 300 pounds of butter fat a year. The fact that her production of butter fat with her first calf may be less than 300 pounds is not entirely determinative of her retention as her production might increase with subsequent gestations where her dam and sire were of lines of good producers of butter fat. Under the petitioner's standard for retention, a bull must be of good conformation, a sure breeder, and be from a dam which has produced 500 pounds of butter fat a year. Not until the offspring of a bull begins milking is petitioner finally able to determine whether a bull fully meets petitioner's standards and is to be re-

tained. However, since only one bull is required for servicing about 35 to 40 cows and heifers, the petitioner is not able to use all of the bulls that are born on the farm, and as a consequence he has a surplus of bulls each year.

Heifers of the Brown Swiss breed can usually be bred at an age of between 15 and 18 months, dependent on the size and weight. The petitioner prefers to have them weigh about 900 pounds before being bred so that they will develop into cows weighing approximately 1,400 pounds when mature. Bulls of the Brown Swiss breed are generally bred at about 15 months of age.

The following is a statement of the number of cattle the petitioner had on hand at the indicated dates, the number raised, the number purchased, and the number sold during the years after holding for six months or more:

On hand	Raised	Purchased	Sold after holding six months or more	On hand
Jan. 1, 1948–241	103	6	55	Dec. 31, 1948–283
Jan. 1, 1949–283	121	6	68	Dec. 31, 1949–258

During 1949, 32 head of cattle were lost by death.

The following is a statement by classes of the number of cattle sold during 1948 and 1949 which had been held by petitioner for six months or more and the amounts received therefor:

	1948		1949	
	No.	Receipts from sales	No.	Receipts from sales
Cows bred and used for milking:				
Age at date of sale—				
24 months			1	$ 79.84
28 months			1	233.79
36 months and over	9	$ 4,011.35	19	4.536.79
	9	$ 4,011.35	21	$ 4,850.42
Heifers:				
Bred but did not drop calf prior to date of sale	10	$ 4,000.00	1	$ 163.20
Not bred	3	185.00	3	625.00
	13	$ 4,185.00	4	$ 788.20
	22	$ 8,196.35	25	$ 5,638.62
Bulls:				
Used for breeding				
Age at date of sale—18 months	1	$ 500.00		
21 months			2	$ 462.16
45 months			1	423.48
60 months			1	364.01
	1	$ 500.00	4	$ 1,249.65
Not bred	32	8,009.21	39	9,346.04
	33	$ 8,509.21	43	$10,595.69
Totals	55	$16,705.56	68	$16,234.31

The following is a statement of petitioner's gross income from the sale of dairy products produced on the farm, from the sale of cattle raised on the farm, and the net loss resulting from farm operations, exclusive of the receipts from the sale of cattle, for the years 1948 and 1949:

Year	Gross income from sale of dairy products	Gross income from sale of cattle	Net loss on farm operations exclusive of receipts from sale of cattle
1948	$48,466.42	$16,705.56	$21,050.10
1949	37,772.03	16,234.31	43,912.55

The Michigan Farmer is a farm magazine published twice monthly and has a circulation comprising a majority of the farmers in Michigan. In a section of that magazine entitled "Breeders' Directory" the petitioner advertised Brown Swiss bulls for sale twice monthly during the months of October 1948 through March 1949, the months of May 1949 through August 1949, and the last three months of 1949. In the early part of 1949 a similar advertisement was carried in the Prairie Farmer, a farm magazine published in Chicago, Illinois. The Brown Swiss Bulletin is published monthly in the interest of improving Brown Swiss cattle as a breed. Petitioner had advertisements in nine issues of that magazine in 1948. Some of the advertisements were for the sale of bulls, others were for the sale of heifers and cows. Advertisements of petitioner's cattle also appeared in the March and April 1949 issues of the Brown Swiss Bulletin in connection with certain public sales of Brown Swiss cattle. The petitioner spent $337 in 1948 and $273.90 in 1949 in advertising his cattle.

During 1948 and 1949 the petitioner exhibited cattle at various dairy cattle shows which were for showing purposes only, and not for sales purposes. Annually, each spring, there are cattle sales at Lake Mills, Wisconsin, to which petitioner occasionally consigns cattle for sale.

The stationery used in connection with petitioner's farm carries the following heading:

> Gotfredson Farms
> Grass Lake, Michigan
> Telephone, Grass Lake 5252
> Breeders of fine Brown Swiss cattle.

Gains from the sale in 1948 and 1949 of cattle which had been raised but held for less than six months were reported by petitioner as ordinary income. Gains from the sale of the cattle involved herein were reported by petitioner as long-term capital gains. In determining the deficiencies in controversy the respondent determined that such gains constituted ordinary income.

OPINION

* * * * *

The remaining issue is whether the gains realized by petitioner on the 55 head of cattle sold in 1948 and the 68 head sold in 1949 constituted long-term capital gains under the applicable provisions of the Internal Revenue Code,[1] as petitioner contends, or were ordinary income, as the respondent determined. The disposition of that question depends upon the determination of the factual question of whether the cattle were held by the petitioner for dairy purposes, as he contends, or were held by him primarily for sale to customers in the ordinary course of business, as the respondent contends.

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[1] SEC. 117. CAPITAL GAINS AND LOSSES.

(a) Definitions.—As used in this chapter—

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the district of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(4) Long-Term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(j) Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.—

(1) Definition of property used in the trade or business.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which

(Continued on next page)

The petitioner's position is that all cattle at the time of birth and until they are sold are to be regarded as held for dairy purposes within the intendment of section 117 (j)(1). However, the evidence shows that the petitioner operates his farm in a manner which results in the sale of a large number of bulls before they have been bred or even have reached the usual breeding age and also in the sale of a substantial number of heifers before having been bred, or if bred before they have dropped a calf. Under the petitioner's standards for the retention of heifers which have dropped a calf, and under his standards for the retention of bulls which have sired offspring, some animals of these classes are sold at or near the beginning of their milk-producing or procreational life. Considering the petitioner's method of operation and the standards employed in determining whether cattle will be retained by him for milking and breeding purposes in connection with the fact that petitioner by his stationery held himself out as a breeder of fine Brown Swiss cattle and further regularly advertised cattle for sale, we think his position that all cattle from birth to sale were held for dairy purposes is untenable and cannot be sustained.

As a consequence the problem before us is to determine which heifers and bulls under the petitioner's method of

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(Continued from preceding page)

is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable. Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition.

* * * * *

Section 117(j)(1), as here set out, contains amendments made thereto by section 324 of the Revenue Act of 1951. By the provisions of section 324 the holding period for livestock for taxable years beginning prior to January 1, 1951, remained at six months or more. The holding period of 12 months or more for livestock was made applicable to taxable years beginning after December 31, 1950.

operation and standards of selection for milk-producing and breeding purposes are to be regarded as having been held by petitioner for dairy purposes.

A similar question was presented in *Walter S. Fox*, 16 T. C. 854, affd. (C. A. 4), 198 F. 2d 719. The taxpayer there was engaged in breeding cattle and the question there was to determine what cattle were members of his breeding herd. We held that heifers which dropped a calf while still owned by the taxpayer were to be regarded as a part of the breeding herd. As to bulls, we held that only those which had reached the age at which it could be satisfactorily determined that they possessed the necessary breeding qualities for such a herd as the taxpayer was raising (found to be 34 months) should be classified as a part of the breeding herd. Cattle not coming within one or the other of the foregoing classifications were held not to be part of the breeding herd, but to be cattle held by the taxpayer primarily for sale to customers. Subsequent to our decision but prior to consideration of the case on appeal, section 117(j)(1) was amended as indicated, *supra*, to define "property used in the trade or business" as including "livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes." In affirming our decision the court of appeals stated that the amendment did not affect the reasoning or conclusion reached by us since the controlling factor was the purpose for which the cattle were held.

The respondent contends that the principles applied in the *Fox* case are applicable here, while the petitioner contends that the factual situation here presented is so different from that in the *Fox* case as to render the principles of that case inapplicable here. While we recognize that the *Fox* case involved cattle held for breeding purposes and the instant cases involve cattle claimed to have been held for dairy purposes, we fail to see how that or other factual differences pointed to by petitioner render the principles of the *Fox* case inapplicable here. Accordingly, we hold them to be applicable.

Before a heifer can become a milker she has to drop a calf. Petitioner's heifers were first bred between 15 and 18 months of age. With a gestation period of approximately nine months, they would be from 24 to 27 months of age at the time of their first calving. Unless they then produced at least approximately 300 pounds of butter fat annually or were of lines of good producers of butter fat, they were disposed of. On the basis of the foregoing it would appear that they would be about 36 to 39 months of age before petitioner determined to retain them for milk-producing purposes. With bulls usually being bred at about 15 months of age, and not until their offspring begin milking is petitioner finally able to determine whether the bulls meet the petitioner's standards for retention, it appears that they would have to be from 48 to 54 months of age before the petitioner determined to retain them. In view of the foregoing it appears that cows under 36 months of age and bulls under 48 months of age could not have attained the petitioner's minimum standards for retention. Accordingly, we hold that cows which were 36 months of age or more, and bulls which were 48 months of age or more, at the time of sale, were held by petitioner for dairy purposes and that the gain on their sale is taxable at capital gain rates. Cows and heifers which were less than 36 months of age and bulls which were less than 48 months of age, at the time of sale, were not held by the petitioner for dairy purposes but instead were held for sale to customers. The gain on their sale is taxable as ordinary income.

Decisions will be entered under Rule 50.

Entered August 31, 1953.

Opinion of Court of Appeals

Gotfredson v. Commissioner of Internal Revenue,
6 Cir., 217 F. 2d 673, decided
December 27, 1954.

Before McALLISTER, MILLER and STEWART, Circuit Judges.

MILLER, Circuit Judge. The petitioners, who filed joint income tax returns, seek a review of rulings of the Tax Court adjudging deficiencies in income taxes for the years 1948 and 1949 in the amounts of $5,922.90 and $4,894.32 respectively. The issue presented is whether gain realized in the taxable years in question from the sale of dairy cattle held by the petitioners for six months or more constituted ordinary income or capital gain.

The principal facts, which are not in dispute, were found by the Tax Court as follows. Since about 1940, the petitioner, Robert B. Gotfredson, has owned and operated what is known as the "Gotfredson Farms," which consists of about 1,500 acres at Grass Lake, Jackson County, Michigan. The principal source of income from the operation of the farm has been from the sale of dairy products. During the years with rainfall normal for the growth of feed and pasture, the farm is capable of maintaing about 325 head of cattle.

The petitioner early adopted the policy of building up a herd of top-grade milk producing cattle of the Brown Swiss breed to the point of maximum operational efficiency on the acreage available. The Brown Swiss breed is considered primarily a milk producer and not a beef producer. In maintaining and improving the efficiency of his dairy herd the petitioner culls out the less desirable animals, replaces the older animals whose production has dropped with younger animals raised on the farm, and from time to time acquires new sires from other herds. Of the animals born on the farm each year the petitioner intends to retain as many as he thinks he can use. However, his aim is to retain the better ones and to cull out the poorer ones in order to improve the quality of his herd. At various stages of development the cattle are judged by predetermined stand-

ards, and the poorer animals which fail to measure up to such standards are sold. These standards are stated in detail in the Tax Court's findings, but need not be repeated here.

Before a heifer can become a milker she has to drop a calf. Petitioner's heifers were first bred between 15 and 18 months of age. With a gestation period of approximately nine months, they would be from 24 to 27 months of age at the time of their first calving. Unless they then produced at least approximately 300 pounds of butter fat annually or were of lines of good producers of butter fat, they were disposed of. The bulls were usually bred at about 15 months of age. Not until the offspring of a bull begins milking is petitioner finally able to determine whether a bull meets petitioner's standards and is to be retained.

The Michigan Farmer is a farm magazine published twice monthly and has a circulation comprising a majority of the farmers in Michigan. In a section of that magazine entitled "Breeders' Directory" the petitioner advertised Brown Swiss bulls for sale twice monthly during the months of October 1948 through March 1949, the months of May 1949 through August 1949, and the last three months of 1949. In 1948, he advertised in nine issues of the Brown Swiss Bulletin, which is published monthly in the interest of improving Brown Swiss cattle as a breed. In 1949, he advertised in the Prairie Farmer, a farm magazine published in Chicago, Illinois. He spent $337.00 in 1948 and $273.90 in 1949 in thus advertising his cattle for sale.

The stationery used in connection with petitioner's farm carried the following heading:

> Gotfredson Farms
> Grass Lake, Michigan
> Telephone, Grass Lake 5252
> Breeders of fine Brown Swiss cattle.

During 1948 and 1949, some of the cattle raised on the farm were sold before attaining the age of six months. Gains from these sales were reported by the petitioner as ordinary income and are not involved in this case. Other cattle were sold after being retained beyond that age, and the gains from these sales were reported by petitioner as long-term capital gains. It was the Commissioner's contention that such gains constituted ordinary income, which resulted in the deficiencies herein involved.

In the case of a taxpayer, other than a corporation, only 50 per centum of the gain recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain and net income, if the capital asset has been held for more than 6 months. There is excluded from the definition of "capital assets" property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. §117(a)(1), §117(b), Internal Revenue Code. In 1942 §117(j) was added, which treated as gains from the sale of capital assets certain gains resulting from the sale of certain property used in the trade or business. But this amendment expressly excluded from such transactions "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Accordingly, without regard to the 1951 amendment, hereinafter referred to, if the cattle sold in 1948 and 1949 was property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, the resulting profit or gain must be treated as ordinary income.

The Tax Court held that under the petitioner's standards cows under 36 months of age and bulls under 48 months of age could not have attained the minimum standards for retention; that cows which were 36 months of age or more and bulls which were 48 months of age or more at the time of sale were held by the petitioner for dairy purposes and not primarily for sale in the ordinary course of trade or business, and that the gain on their sale was taxable at capital gain rates; but that cows and heifers which were less than 36 months of age and bulls which were less than

48 months of age at the time of sale were not held by petitioner for dairy purposes, but instead were held for sale to customers in the ordinary course of trade or business, and that the gain on their sale was taxable as ordinary income. The deficiencies resulting from these rulings are what we are asked to review.

Prior to 1951 there was considerable dispute between the Commissioner and farmers with regard to the application of Sec. 117(j) to sales of livestock. The Commissioner's contention that such sales were not sales of capital assets was rejected by the Courts on several occasions. See *Albright v. Commissioner*, 173 F. (2d) 339, C. A. 8th; *United States v. Bennett*, 186 F. (2d) 407, C. A. 5th; *Miller v. United States*, 98 Fed. Supp. 948 (Neb.); *Fawn Lake Ranch Co. v. Commissioner*, 12 T. C. 1139; *Flato v. Commissioner*, 14 T. C. 1241. In 1951 Congress amended Section 117(j) to make it clear that "property used in the trade or business . . . includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months* or more from the date of acquisition," but not including poultry. Petitioners rely upon the foregoing cases and the 1951 amendment in support of their contention that as a matter of law the sales in question are to be treated as sales of capital assets.

The purpose of the 1951 amendment was chiefly to clarify the issue and to recognize by statutory enactment the rulings which had been made by the Courts as hereinabove indicated. We do not think it broadened the rule of those cases. We do not give to the words "regardless of age" the construction urged by the petitioner that all new born heifers and bulls are treated as capital assets from the time of birth. We construe it as meaning that the sale of cattle from the herd, after having served in the herd, is the sale of a capital asset, even though the animal is still comparatively young, has not exhausted its usefulness, and is sold at a younger age than is usually the case. Such construction is consistent with the purpose of the amendment to

*Six months for the taxable years in question.

settle the Commissioner's contention to the contrary, and as made by him in the cases referred to. The amendment still requires that the cattle be "held by the taxpayer for . . . dairy purposes."

We are of the opinion that the ruling in the foregoing cases is not applicable to our present problem. In those cases the taxpayer culled out from his herd of cattle certain old or inferior animals who had served as part of the herd over a period of time, and replaced them with younger animals. We agree that the cattle so sold and replaced had been held for breeding or dairy purposes. They had actually been used over a period of time for that purpose, and their *ultimate* sale did not destroy that fact. The statute refers to property held *"primarily"* for sale. In the present case the cattle sold had not yet qualified to become a part of the herd. This distinction is referred to in *Fox v. Commissioner,* 198 F. (2d) 719, 723, C. A. 4th, upon which case the Commissioner strongly relies. Allowing for the immaterial difference of a breeding herd in that case and a dairy herd in the present case, we consider the cases closely parallel. The Court held that the young cattle which were sold before they became a part of the breeding herd were not held for breeding purposes within the meaning of Section 117(j), Internal Revenue Code.

In this case, as in that case, the evidence shows that it was the intention of the taxpayer at all times to sell a substantial portion of the new-born animals, and that such intention was carried out before they became a part of the herd. As shown by the advertising and by the letterhead, the sale of a certain portion of the young cattle was a regular part of his business. As pointed out in the *Fox* case, although the cow and the bull which produced the calf may be a part of the herd and a capital asset when sold, the calf and the milk are not property used in the trade or business but are instead the produce of such property. Whether the calves will be sold or held for dairy purposes is not decided until many months later.

Petitioners contend that the Tax Court's ruling incorrectly construes the words in Section 117(j) "held by the taxpayer for . . . dairy purposes" as meaning "used" by the taxpayer for dairy purposes, and that it is not necessary under the statute that the calves and bulls be actually used for dairy purposes. We agree that the ultimate use of the young animals is evidence of the purpose for which they were held, but that it is not the only test, and that young cattle *could* be held for dairy purposes even though not ultimately so used. Accidents, sickness, weather and farm conditions (see *Pfister v. United States,* 102 Fed. Supp. 640), financial considerations, and other factors might cause a change of purpose before actual use. But we do not agree that the ruling was based exclusively on the fact that the animals were not actually used for dairy purposes. Other facts were also considered by the Tax Court in determining that the animals were not "held" for dairy purposes.

We recognize that the Court of Appeals for the Second Circuit in *McDonald v. Commissioner,* 214 F. (2d) 341, has recently reached a different result from that reached in *Fox v. Commissioner, supra.* If this matter was before us in a trial *de novo* the reasons given for the ruling in that case would be persuasive. The two cases represent different conclusions from similar factual situations, both reasonably arrived at. But, eliminating the legal issues involved, hereinabove discussed, the basic question remaining is one of fact. *Dougherty v. Commissioner,* — Fed. (2d) —, C. A. 6th; decided October 21, 1954; *Winnick v. Commissioner,* 17 T. C. 538, 199 F. (2d) 374, C. A. 6th; *Home v. Commissioner,* 212 F. (2d) 637, C. A. 10th; *Rider v. Commissioner,* 200 F. (2d) 524, C. A. 8th; see also, *United States v. O'Neill,* 211 F. (2d) 701, C. A. 9th. We are unable to say that the facts in this case do not support the Tax Court's finding that the heifers and bulls sold by the taxpayer before they were accepted into the herd were not held for dairy purposes, but instead were held for sale to customers, or that such finding is clearly erroneous. Unless clearly erroneous, the finding is binding upon us. Sec. 1141(a), Title 26 U. S. Code; Rule 52(a) Rules of Civil Procedure; *Rider v. Commissioner, supra; Schwartz v. Commissioner,* 185 F. (2d) 760, 763-764, C. A. 7th. See

United States v. Gypsum Co., 333 U. S. 364, 394; *Miller v. Commissioner*, 183 F. (2d) 246, 252, C. A. 6th.

The judgments are affirmed.

Order Denying Petition for Rehearing

(Filed February 25, 1955)

The Court having considered the petition for rehearing filed by the petitioners herein;

IT IS ORDERED that said petition for rehearing be denied.

APPENDIX C

CONFLICTING OPINION

McDonald v. Commissioner of Internal Revenue, 2 Cir., 214 F. 2d 341, decided July 7, 1954.

Before Clark and Hincks, Circuit Judges.

Clark, Circuit Judge: This petition for review of a decision of the Tax Court of the United States involves the tax treatment under I. R. C. Sec. 117(j) of the proceeds from sale of cattle from a dairy and breeding herd. From the facts found the following appears:

The taxpayer, James M. McDonald, during 1946 was the owner of a dairy and breeding herd of pure bred Guernsey cattle. It was one of the best herds of Guernsey cattle in the country, a status achieved after some 13 years of careful selective breeding. It was the taxpayer's practice, after carefully controlling the mating of his animals, to cull as rapidly as possible those calves which did not measure up to the high standards of his herd. Some calves were rejected at birth, but the great majority were screened out during the periodic inspections which commenced at the seventh month. When unsatisfactory characteristics developed, sometimes only in the animal's offspring or grandchildren, the animal was sold. Nature being what it is, many more bulls than heifers were thus disposed of.

Taxpayer had never retained a fixed percentage of calves, but had kept as many each year as proved suitable. In addition to the animals thus raised he had purchased animals from other herds in further efforts to improve his strain. The size of his herd had grown in every year but two, since its inception in 1933.

[*24 or More Months of Age*]

In 1946 the taxpayer sold 201 animals of varying ages, some of which had been raised, and others acquired by purchase. The proceeds from those which he had held less than six months he reported as ordinary income; the rest he reported as capital gain. The Commissioner determined that all of these receipts were taxable as ordinary income, and filed a notice of deficiency. On review the Tax Court held, 17 T. C. 210, that those animals acquired by purchase and those raised animals which were 24 or more months of age were "property used in the trade or business" within I. R. C. Sec. 117(j) (1) as it then stood, and hence were entitled to capital treatment. The other animals were held to have been sold in the ordinary course of business and the proceeds treated as ordinary income. Thereafter Congress enacted Sec. 324 of the Revenue Act of 1951 which retroactively amended Sec. 117(j) (1) to include within "property used in the trade or business" "*livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes*" for more than six months. (Italics supplied.) Taxpayer moved in the Tax Court to vacate or revise its order; but after a hearing the motion was denied, largely on the authority of *Walter S. Fox*, 16 T. C. 854, affirmed *Fox v. C. I. R.*, 4 Cir., 198 Fed. (2d) 719. Thereafter the taxpayer petitioned for review here.

The question of purpose for which an animal is held is essentially one of fact. *United States v. O'Neill*, 9 Cir., 211 Fed. (2d) 701; *Fox v. C. I. R., supra.* We have no doubt that in many cases it is readily resolved; but upon the facts here, the answer is not so simply deductible. As the Tax Court found, the taxpayer initially retained all of the cattle here involved with the hope that they would

measure up to his high standards. On the other hand, it was always clear and predictable that each year substantial numbers of them would eventually be culled and sold. It was this predictability which led the Tax Court to the view that the young animals were held for sale up to the point where their breeding qualities had been tested by examination of their offspring. This period of time it fixed at 24 months; and so it held the proceeds of cattle sold earlier to be only income.

[*The Fox Case*]

The case of *Fox v. C. I. R., supra,* dealt with a similar situation. The taxpayers in that case raised Aberdeen Angus cattle for use in their breeding herd and for sale as breeders. It appears that the age at which they sold their young animals depended on the varying preferences and desires of purchasers. This differs sharply from the practice herein, which was to cull animals for sale as rapidly as they evidenced undesirable characteristics.[1] So these facts of the *Fox* case would afford some basis for a conclusion that there the animals were held for sale.

In justice to the Tax Court, however, which relied on this case in denying the motion to vacate or revise its decision, we must grant that this circumstance was given little weight in the opinion of the Fourth Circuit Court of Appeals. The opinion emphasized the regularity and high proportion of sales and the failure to test breeding qualities before disposing of the animals. And it pointed very strongly to the results reached by the Tax Court herein.

We think, however, that this view penalizes breeders with skill sufficient to detect and cull inferior animals even before they have been bred. True, an affirmative judgment

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[1] Counsel for the taxpayer raises another possible distinction in his claim that the appreciation in value of beef calves more than covers the cost of their maintenance, whereas, the reverse is true with dairy calves. If this is so it is strongly persuasive that the motive for holding these dairy calves was not sale, but inclusion in the breeding herd. The Tax Court, however, made no finding on this point; and since the record is inconclusive, we disregard it.

that an animal is superlative cannot be made without examination of its offspring. But the evidence is compelling that a negative judgment can often be made on the basis of such factors as brightness of eyes, width of nostrils, size of muzzle, length of neck, sharpness of shoulders, depth of chest and spring of ribs, straightness of back, width and level of rump, and, in the case of a cow, size of udder and its firm attachment to the body. Thus younger animals can be accurately culled, and the animals which the taxpayer sold were selected in this manner. Before an animal had been thus weeded out it was part of the regular herd, held for dairy and breeding purposes until it should prove unfit. See *O'Neill v. United States,* D. C. S. D. Cal, affirmed *United States v. O'Neill,* 9 Cir., 211 Fed. (2d) 701; *Pfister v. United States,* D. C. S. D. 102 Fed. Supp. 640, reversed on other grounds *United States v. Pfister,* 8 Cir. 205 Fed. (2d) 538.

Of course it was in the taxpayer's contemplation that many or most of the nimals would be found wanting and be sold. The operation might perhaps even have proved unfeasible without the income thus derived. And in a very real sense the taxpayer could have said at any moment that most of his calves were held for possible sale. But this was not the motive behind their retention, and legislative history of the new law shows that motive is to be controlling. And it is this new law which is and must be decisive.

[*1951 Amendment*]

Prior to this 1951 amendment the Commissioner had first refused to recognize that livestock could qualify for treatment under the capital gains provision, and then had ruled that only unusual reductions of herd would suffice. A series of adverse rulings in the courts, *Albright v. United States,* 8 Cir., 173 Fed. (2d) 339; *United States v. Bennett,* 5 Cir., 186 Fed. (2d) 407; *Miller v. United States,* D. C. Neb., 98 Fed. Supp. 948, led him to modify his position so as to allow such treatement of animals sold after being employed for substantially their full period of usefulness.

Treas. Dept. Bull. June 17, 1951, *Mim. 6660,* 1951-2 Cum. Bull. 60. But all of the foregoing cases had given the section a far more liberal interpretation than this, granting favored treatment to the proceeds from young animals, and in two of the cases[2] from heifers (females which had never dropped a calf).

When Congress undertook to amend Sec. 117(j)(1), it was made fully cognizant of this situation by representatives of livestock and breeding associations. Hearing before Committee on Finance on H. R. 4473, Revenue Act of 1951, Part 3, pp. 1538, 1837, 2396; Sen. Rep. No. 781, 82d Cong., 1st Sess. 41-42. And it is manifest that the section was drafted with an eye to the breeders' complaints. Thus in defining property "used" in the business the amendment speaks of livestock "held" for an appropriate purpose, and adds the further proviso that it apply "regardless of age." The intent to repudiate the Commissioner's view is obvious, even without the specific statements in the Report of the Senate Committee on Finance, *supra.* And it is equally clear that the animals need not be mature and need not have been put to its intended use.

Hence we cannot accept the Tax Court's ruling that the animals must be 24 months old, the age at which they have presumptively had offspring. Equally we disapprove the view that an animal is held for breeding purposes only if there is an expectation and intention that it produce offspring. Life is replete with situations (advertising, war, reproduction) where many are employed in the hope that one will succeed. Yet the purpose subserved by the many is clear. This does not mean that every farmer can obtain the benefit of the capital gains provision for his entire calf crop merely by selecting one of the better looking animals every time he needs a replacement for his producing herd. This taxpayer, however, has made a thoroughly

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[2] *Albright v. United States, supra,* 8 Cir., 173 Fed. (2d) 339, and *Miller v. United States, supra,* D. C. Neb., 98 Fed. Supp. 948. The court in the *Miller* case indicated its belief on apparently some special information that *United States v. Bennett, supra,* 5 Cir., 186 Fed. (2d) 407, also involved the sale of heifers. 98 Fed. Supp. at p. 956.

convincing record that his retention of calves was a necessary factor in building his champion herd. He is entitled to the benefit of I. R. C. Sec. 117 (j) (1) in its new and revised form.

[*Losses for 5 Years*]

There remains the Commissioner's alternative position in the Tax Court that if the proceeds of these sales are treated as capital gains, then the taxpayer's statutory gross income would be reduced, thereby increasing his operating loss deduction which has been continuous from the beginning of his operations. See *United States v. Benedict*, 338 U. S. 692. This recomputation, the Commissioner asserts, would bring the taxpayer within the provisions of I. R. C. Sec. 130, which limits deductions on operating losses continuing over a five-year period. Section 130, first appearing in the 1943 Revenue Act, was aimed to prevent the deduction of excessive "hobby losses" and requires a recomputation of net income and limitation of deduction where losses for five consecutive years have exceeded gross income from the business by $50,000 for each of such years. The Tax Court did not reach this point. Since the Commissioner did not petition for review, he can use the claim only defensively to sustain such part of the decision as is already in his favor. *Rosenthal v. C. I. R.*, 2 Cir., 205 Fed. (2d) 505; *Helvering v. Gowran*, 302 U. S. 238, 245. But he is clearly entitled to use it to that extent; and since the point was not developed in the Tax Court, it should be made there with adequate findings on the remand. The decision must therefore be reversed and the proceedings remanded to the Tax Court for further action in accordance with this opinion.

Revised and remanded.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and Regulations involved	2
Statement	2
Argument	6
Conclusion	12
Appendix	13

CITATIONS

Cases:

McDonald v. *Commissioner*, 23 T.C. No. 138	10, 11
McDonald v. *Commissioner*, 214 F. 2d 341	6, 10, 11
Rider v. *Commissioner*, 200 F. 2d 524	6
Stockton Harbor Indus. Co. v. *Commissioner*, 216 F. 2d 638, certiorari denied, 349 U.S. 904	6
Victory Housing No. 2 v. *Commissioner*, 205 F. 2d 371	6

Statutes:

Internal Revenue Code of 1939, Sec. 117 (26 U.S.C. 117)	6, 13
Revenue Act of 1951, c. 521, 65 Stat. 452, Sec. 324 (26 U.S.C. 117)	6, 16

Miscellaneous:

Treasury Regulations 111:	
Sec. 29.117-7	17

In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 64

ROBERT B. GOTFREDSON AND CHARLOTTE B. GOTFREDSON, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 4a-15a) are not officially reported. The opinion of the Court of Appeals (Pet. 26-32) is reported at 217 F.2d 673.

JURISDICTION

The judgment of the Court of Appeals was entered on December 27, 1954. A petition for rehearing was denied February 25, 1955. (Pet. 32.) The petition for a writ of certiorari was filed on

May 9, 1955. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether, on the particular facts of this case, the Court of Appeals was justified in affirming the Tax Court's factual conclusions that certain cattle did not constitute livestock held for dairy purposes, but, instead, constituted cattle held for sale to customers in the ordinary course of the taxpayer's trade or business, with the consequence that the taxpayer was not entitled to capital gain treatment under Section 117 (j) of the Internal Revenue Code of 1939, as amended.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of Section 117 of the Internal Revenue Code of 1939; Section 324 of the Revenue Act of 1951; and Section 29.117-7 of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 13-20.

STATEMENT

The facts, substantially as found by the Tax Court (Pet. 17-21), are as follows:

During the taxable years in question, taxpayer Robert B. Gotfredson [1] owned and operated a 1,500 acre farm at Grass Lake, Jackson County, Michigan (Pet. 17). On this farm he was engaged in establishing a herd of top-grade milk-producing cattle of the Brown Swiss breed (Pet. 18). During the

[1] Because of the filing of joint returns, both husband and wife are the taxpayers. For convenience, the husband will be referred to as the taxpayer.

taxable years in question the herd ranged between 250 to 300 head (R. 39). The taxpayer was endeavoring to operate the farm on a profitable basis (Pet. 18), and the principal sources of farm income were sales of dairy products and cattle (Pet. 17, 20). The Brown Swiss breed is considered to be a milk producer rather than a beef producer (Pet. 18). Results from farm operation for the two years in question were as follows (Pet. 20):

Year	Gross income from sale of dairy products	Gross income from sale of cattle	Net loss on farm operations exclusive of receipts from sale of cattle
1948.....	$48,466.42	$16,705.56	$21,050.10
1949.....	37,772.03	16,234.31	43,912.55

In his effort to place the farm on a profitable basis through maintenance of improved efficiency in the herd, the taxpayer has followed the practice of selective culling, i.e., at various stages of development the cattle are judged by predetermined standards with a view to retaining the better animals and of disposing of the poorer ones which fail to measure up to such standards (Pet. 18). These standards for both cows and bulls are detailed in the Tax Court's opinion, below. (Pet. 18-19.) Summarized, in the case of cows, a heifer must be of good conformation and at first calving, as a two year old, produce at least approximately 300 pounds of butter fat a year. Under the standards for retention, a bull must be of good conformation, a sure breeder, and be from a dam which has produced 500 pounds of butter fat a year. Not until the offspring of a bull begins milking is taxpayer

finally able to determine whether a bull fully meets taxpayer's retention standards. (Pet. 18.) This follows from the ultimate criterion that his offspring's milk production must meet an annual minimum of 300 pounds of butter fat. However, since only a limited number of bulls is required, the taxpayer is not able to use all the bulls born on the farm, and has a surplus of bulls each year. (Pet. 19.)

Heifers of the Brown Swiss breed can usually be bred at an age of between 15 and 18 months, dependent on their size and weight. Bulls of the Brown Swiss breed are generally bred at about 15 months of age. (Pet. 19.) The gestation period for a bred heifer is approximately nine months. As a consequence of these standards, it follows that a heifer, bred at 15 months, will not qualify for retention in the herd until she has calved as a two year old and built up a minimum annual production record of 300 pounds of butter fat, requiring a minimum period of 36 months. A bull, bred at 15 months, will not qualify until its offspring calves as a two year old and produces a minimum of 300 pounds of butter fat during its first year of milking, entailing a minimum period of 48 months. (Pet. 25.)

In 1948, the taxpayer sold 55 animals which he had held for six months or more for $16,705.56. In 1949, he sold 68 for $16,234.31 (Pet. 19-20). Tables showing the sex and age distribution of the animals sold appear on pages 19 and 20 of the Petition.

With respect to the sale of Brown Swiss bulls, taxpayer advertised twice monthly in the Breeders' Directory of the Michigan Farmer, a farm magazine, from October, 1948, through December, 1949, excluding only the months of April and September, in the latter year (Pet. 21). Early in 1949, a similar advertisement was run in the Prairie Farmer, a farm magazine published in Chicago. In addition, taxpayer advertised in nine of the 1948 issues of the Brown Swiss Bulletin, a monthly published in the interest of improving Brown Swiss cattle as a breed. (Pet. 21.) In March and April, 1949, taxpayer advertised his cattle in the Brown Swiss Bulletin in connection with certain public sales. Altogether, taxpayer spent $337 in 1948, and $273.90 in 1949, in advertising his cattle. (Pet. 21.)

Taxpayer's stationery used in connection with the farm, carries the letterhead (Pet. 21)—

> Gotfredson Farms,
> Grass Lake, Michigan,
> Telephone, Grass Lake 5252
> Breeders of fine Brown Swiss cattle.

Gains from the sale in 1948 and 1949 of cattle which had been raised but held for less than six months were reported by taxpayer as ordinary income. Gains from the sale of cattle held for more than six months were reported by taxpayer as long-term capital gains. (Pet. 21.) The Commissioner determined deficiencies for those years. The Tax Court held that gains realized on the sale of 46 head of cattle in 1948 and 48 head in 1949 were taxable as

ordinary income. (Pet. 25.) The Court of Appeals affirmed. (Pet. 26-32.)

ARGUMENT

1. The Court of Appeals was correct in affirming the Tax Court's decision holding that the taxpayer realized ordinary income rather than capital gain on the sale of certain cattle in 1948 and 1949.

The preferential taxation of gains on the sale of capital assets was extended by Section 117(j) of the Internal Revenue Code of 1939 (Appendix, *infra,* pp. 14-16) to "property used in the trade or business" and not held "primarily for sale to customers" in the ordinary course of the taxpayer's trade or business. The statute as amended by Section 324, Revenue Act of 1951 (Appendix, *infra,* p. 16), expressly includes as property used in the trade or business "livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes."

The ultimate questions whether particular property is being used in the taxpayer's trade or business and, if it is, whether it is nevertheless being held by the taxpayer primarily for sale to customers are uniformly regarded as presenting questions of fact, the resolution of which are committed to the fact finders. *Stockton Harbor Indus. Co.* v. *Commissioner,* 216 F. 2d 638 (C.A. 9th), certiorari denied, 349 U.S. 904; *McDonald* v. *Commissioner,* 214 F.2d 341 (C.A. 2d); *Rider* v. *Commissioner,* 200 F. 2d 524 (C.A. 8th); *Victory Housing No. 2* v. *Commissioner,* 205 F.2d 371 (C.A. 10th). Consequently,

these questions present issues on which appellate courts properly exercise only a limited scope of review.

Recognizing that the Tax Court had decided a factual matter in the context of the particular record of this case and that its own reviewing function did not go beyond determining whether the findings were (Pet. 31-32) "clearly erroneous," the Court of Appeals held, properly we believe, that the Tax Court's conclusion that the cattle sold (Pet. 31) "were not held for dairy purposes, but instead were held for sale to customers" was supported by the facts and therefore could not be described as clearly erroneous.

A brief examination of some of the record evidence is persuasive that the court below was correct in so ruling. Of the 46 head of cattle sold in 1948, with respect to which capital gain was denied, 32 were bulls which had not been bred.[2] In 1949, 39 bulls had not been bred. The evidence showed that only a limited number of bulls are needed for the dairy herd and that the taxpayer has a surplus of bulls each year (Pet. 19). In determining which of the many surplus bulls would be sold each year, the taxpayer's standard for retention was that (Pet. 18) "a bull must be of good conformation, a sure breeder, and be from a dam which has produced 500 pounds of butter fat a year." Since these

[2] The taxpayer had claimed capital gain on 55 and 68 head of cattle sold in 1948 and 1949, respectively. The Tax Court allowed capital gain treatment on the sale of 9 cows in 1948 and 19 cows and 1 bull in 1949. (Pet. 20, 25.)

particular bulls had not been bred, the taxpayer's decision to sell must have been for some reason other than their failure to qualify as "sure" breeders. Indeed, there is nothing in the record to negate the conclusion that these particular bulls, or some of them at least, lacked the necessary hereditary factors and because of this never were qualified to be used as part of the dairy herd under taxpayer's standards. Their dams in that situation would have been bred solely to freshen them rather than to obtain the calves (R. 22). Others may have failed to meet the standards as to conformation from the start. Under these circumstances it was a permissible inference that the taxpayer had always intended to sell them to his customers. With respect to the bulls which had been sold after having been bred (one being sold in 1948 and three being sold in 1949), the evidence would indicate that these particular animals had never achieved the taxpayer's additional standard that their offspring have a minimum milk production record. (Pet. 18-19.)

The other cattle sold in 1948, with respect to which capital gain treatment was denied, consisted of 13 heifers, 3 of which had not been bred and 10 of which had been bred but had not dropped calves prior to the sale. Similarly, in 1949, 3 heifers were sold which had not been bred and 1 was sold which had been bred but had not dropped a calf. Since, with respect to cows, the taxpayer's standards for retention in the dairy herd required heredity, good conformation, and a minimum butter fat production at first calving (R. 41; Pet. 18) and since all

these heifers had been sold prior to any milk production, it seems plain that they were sold, not because of any failure to meet milk production standards, but because they never met some initial qualification. Here, too, the conclusion seems justified that the taxpayer never intended that these animals would be held for breeding or dairy purposes, and must have always intended to sell them to his customers.

The only remaining cattle which were sold and which the Tax Court held did not qualify for capital gain treatment consisted of one cow sold for $79.84 at the age of 24 months, and another sold for $233.79 at 28 months of age, both sales taking place in 1949. There is no express evidence explaining the reasons why these particular animals were sold or whether they had been held for dairy purposes rather than for sale to customers.

The evidence also shows that the taxpayer, on his stationery, held himself out as a breeder of fine Brown Swiss cattle, and had engaged in extensive advertising for the sale of bulls, heifers, and cows.

On this record the Tax Court was fully justified in concluding that the taxpayer, on whom rested the burden of proof, had not established that these particular animals were being held for breeding or dairy purposes and had not disproved that they were being held for sale to customers in the ordinary course of taxpayer's business. Consequently, it was properly held that the gain from the sales did not qualify for capital gain treatment under Code Section 117(j). The Court of Appeals was correct in affirming.

2. The taxpayer, in seeking further review by this Court, predicates his petition (pp. 7-10) primarily on the assertion that the decision in this case is in conflict with the decision of the Second Circuit in *McDonald* v. *Commissioner,* 214 F. 2d 341, where the Tax Court was reversed for having denied capital gain treatment in a somewhat analagous setting. Although the facts in the two cases are in many respects similar, the Second Circuit placed some reliance on the finding "Some calves were rejected at birth, but the great majority were screened out during the periodic inspections which commenced at the seventh month." (Pet. 32.) The record in the present case would not justify such a finding here since, as pointed out above, there is no way of knowing how many of the animals were sold for hereditary failures or defects which were apparent at birth. Furthermore, the regular advertising used by petitioner here to promote his sales and the fact that he held himself out as a breeder might be considered a distinguishing factor from the more limited sales methods followed by the taxpayer in the Second Circuit case.

The factual differences between the cases are such that it cannot be said with certainty that the Second Circuit, on the present record, would not have affirmed the decision of the Tax Court, just as did the court below. In this connection, it may be noted that in *McDonald* v. *Commissioner,* 23 T. C. No. 138, involving different taxable years but the same essential facts as in the earlier *McDonald* case, the Tax Court (with six judges dissenting),

although indicating that it was not bound to do so, was persuaded by the Second Circuit's opinion to reevaluate the facts and to conclude that the cattle sold were not being held for sale and were being held for dairy purposes. It is significant that in the latest *McDonald* case the Tax Court referred to the present case, mentioned that, even though they were similar, there were factual differences between the cases, and did not disavow its decision here. Consequently, the rationale of the Second Circuit's decision in *McDonald,* while persuasive to the Tax Court in the factual context of that case, did not persuade it that an erroneous decision had been reached under the different facts of this case.

The Court of Appeals here, while stating that if it were free to evaluate the facts (Pet. 31) "in a trial *de novo*" would have found the Second Circuit's opinion persuasive, felt itself bound by the "clearly erroneous" rule to affirm in the light of the facts of this case. The Second Circuit in *McDonald* (Pet. 33) also recognized that a fact question was presented, but considered that the record in that case required a reversal. If any real divergence exists between the two circuits, it is, at most, a difference in application of the clearly erroneous rule in the context of different factual records. This, we believe, poses no question meriting review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
HILBERT P. ZARKY,
DAVIS W. MORTON, JR.,
Special Assistants to the Attorney General.

JULY, 1955.

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l);

* * * * *

(4) [as amended by Sec. 150(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(b) [as amended by Sec. 150(c) of the Revenue Act of 1942, *supra*] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a

corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, *supra,* and amended by Sec. 127 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary

course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade

or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U.S.C. 117.)

Revenue Act of 1951, c. 521, 65 Stat. 452:

SEC. 324. SALES OF LIVESTOCK.

Section 117(j)(1) is hereby amended by adding at the end thereof the following new sentences: "Such term also includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry." The first sentence added to section 117(j)(1) by the amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1941, except that the extension of the holding period from 6 to 12 months shall be applicable only with respect to taxable years beginning after December 31, 1950. The second sentence added to section 117(j)(1) by the amendment made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

(26 U.S.C. 117.)

Treasury Regulations 111:

SEC. 29.117-7 [as amended by T.D. 5970, 1953-1 Cum. Bull. 183]—*Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.*—

(a) *In general.* (1) Section 117(j) provides that the recognized gains and losses described below shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. The gain and losses referred to above are the following:

* * * * *

(iv) Gains and losses from the sale, exchange, or involuntary conversion of livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for more than six months from the date of acquisition (twelve months or more from the date of acquisition in the case of a taxable year beginning after December 31, 1950).

* * * * *

(c) *Livestock held for draft, breeding, or dairy purposes.* For the purpose of this section, the term "livestock" shall be given a broad, rather

than a narrow, interpretation and includes cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, and other mammals. It does not include chickens, turkeys, pigeons, geese, other birds, fish, frogs, reptiles, etc.

The determination whether or not livestock is held by the taxpayer for a draft, breeding, or dairy purpose depends upon all of the facts and circumstances in each particular case. The purpose for which the animal is held is ordinarily shown by the taxpayer's actual use of the animal. However, a draft, breeding, or dairy purpose may be present in a case where the animal is disposed of within a reasonable time after its intended use for such purpose is prevented by accident, disease, or other circumstance. An animal held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business may, depending upon the circumstances, be considered held for a draft, breeding, or dairy purpose. An animal is not held by the taxpayer for a draft, breeding, or dairy purpose merely because it is suitable for such purpose or because it is held by the taxpayer for sale to other persons for use by them for such purpose. Furthermore, an animal held by the taxpayer for other purposes is not considered to be held for a draft, breeding, or dairy purpose merely because of a negligible use of the animal for such purpose or because of the use of the animal for such purpose as an ordinary or necessary incident to the purpose for which the animal is held.

These principles may be illustrated by the following examples:

Example 1. An animal intended by the taxpayer for use by him for breeding purposes is discovered to be sterile, and is disposed of within a reasonable time thereafter. This animal was held for breeding purposes.

Example 2. The taxpayer retires from the breeding or dairy business and sells his entire herd, including young animals which would have been used by him for breeding or dairy purposes if he had remained in business. These young animals were held for breeding or dairy purposes.

Example 3. A taxpayer in the business of raising hogs for slaughter customarily breeds sows to obtain a single litter to be raised by him for sale, and sells these brood sows within a reasonable time after obtaining the litter. Even though these brood sows are held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business, they are considered to be held for breeding purposes.

Example 4. A taxpayer in the business of raising horses for sale to others for use by them as draft horses uses such horses for draft purposes on his own farm in order to train them. This use is an ordinary or necessary incident to the purpose of selling such animals, and, accordingly, these horses are not held for draft purposes.

Example 5. The taxpayer is in the business of

raising registered cattle for sale to others for use by them as breeding cattle. It is the business practice for the cattle to be bred, prior to sale, in order to establish their fitness for sale as registered breeding cattle. In such case, those cattle used by the taxpayer to produce calves which calves are added to the taxpayer's herd (whether or not the breeding herd) are considered to be held for breeding purposes; the breeding of other cattle is an ordinary or necessary incident to the holding of such other cattle for the purpose of selling them as registered breeding cattle, and the breeding of such cattle does not demonstrate that the taxpayer is holding the cattle for breeding purposes.

Example 6. A taxpayer, engaged in the business of buying cattle and fattening them for slaughter, purchased cows with calf. The calves were born while the cows were held by the taxpayer. These cows were not held for breeding purposes.

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